IN THE HIGH COURT OF KARNATAKA, BANGALORE

DATED THIS THE 31st DAY OF JULY, 2009

PRESENT

THE HON'BLE MR. JUSTICE V.GOPALA GOWDA
AND
THE HON'BLE MR. JUSTICE ARAVIND KUMAR

I.T.A NO.458 OF 2004

BETWEEN

1. The Commissioner of Income-tax,
C.R.Building,
Queens Road,
Bangalore.

2. The Deputy Commissioner
Of Income-Tax,
C.R.Building,
Queens Road,
Bangalore.

: Appellants

(By Sri.M V.Seshachala, Advocates)

AND:

M/s Tata Coffee Ltd.,
(Formerly Known as
Consolidated Coffee Ltd)
Polibetta-571215,
Coorg District.

: Respondent

(By Sri.S.G.Sarangan, Senior Advocate for Smt.Vani.H.)

This Appeal is filed under Section 260A of Income Tax Act, 1961 to allow the appeal and set aside the order passed by the ITAT, Bangalore ITA No.526/Bang/1999 dated 24-2-2004 and confirm the order passed by the Deputy Commissioner of Income Tax, Special Range-2, Bangalore.

This Appeal having been heard and reserved coming on for pronouncement of judgment, this day, **ARAVIND KUMAR J,** delivered the following:

JUDGMENT

This appeal by the Revenue under Section 260A of the Income Tax Act, 1961(Act, for short) as against the order dated 24-2-2004 passed by ITAT, Bangalore Bench-B in ITA 526/Bang/99 relating to the assessment year 1995-96.

2. The assessee is engaged in the business of cultivating coffee, selling it and exporting the same among other businesses. During the assessment year, the assessee sold plant, machinery, equipment and technology for manufacture of quartz Alaram Time pieces at Hyderabad for a sum of Rs.2,56,50,000/- to

Titan Industries Limited. As per the sale agreement the assessee was not entitled to deal with watch sales for a period of 10 years. The assessee filed a return of income on 30-11-1995 declaring a total income of Rs.7,49,630/-. The Assessing Officer found during the course of assessment proceedings that a sum of Rs.30,00,000/- had been paid to the assessee as non competition fee by Titan Industries. Since the SIFCO Vender which was manufacturing Alaram Time pieces was part and parcel of the assessee and discontinuance of that particular unit did not involve loss of enduring trading asset, the competition fee of Rs.30,00,000/- was treated as the income of the assessee as per the assessment order dated 22-1-1998-(Annexure-C).

3. The assessee being aggrieved by the same filed an appeal before the CIT (appeals). The Appellate Authority found that out of Rs.30,00,000/- non-competition fee received by the assessee that

Rs.10,00,000/- was towards goodwill and balance of Rs.20,00,000/- was towards fee. In so far as Rs.10,00.000/- paid towards goodwill, the matter was remitted back to the Assessing Officer for reconsideration and deleted the addition of Rs.20,00,000/- made by the Assessing Officer by holding it as capital receipt and not liable for Income tax and allowed the appeal by order dated 11-6-1999 (Annexure-B).

4. The revenue being aggrieved by the same filed an appeal before the Tribunal. The Tribunal rejected the appeal filed by the revenue holding that this amount of Rs.20,00,000/- paid to restrain the assessee from not conducting the said business for 10 years period as capital receipt and confirmed the order of CIT(A) by order dated: 24-2-2001 (Annexure-A). The Tribunal further held that Section 55(2) of the Act had been introduced by Finance Act of 1998 and was applicable

from the assessment year 1998-99 onwards and not to the assessment year in question i.e., 95-96.

5. Feeling aggrieved the revenue has filed this appeal contending that following substantial questions of law arise for consideration on the facts and circumstances:

> " (i) Whether the appellate authorities were correct in holding that a sum of Rs.20 lakhs received by the assessee as non-competition fee from M/s Titan Industries Limited for sale of its 'quartz alarm time piece units' along with plant and machinery goodwill etc., should be treated as a capital receipt or the same should be treated as a revenue receipt as held by the assessing officer?
>
> (ii) Whether the assessee which was carrying on number of business activities had transferred only one such activity not resulting in cessation of the rest of the business nor creating a loss of any enduring trading asset and therefore the sum of Rs.20

lakhs non competition fee cannot be treated as an item not liable to tax.?"

6. We have heard Sri.M.V.Seshachala, learned Senior Standing counsel for the revenue and Sri.G.Sarangan, learned Senior Counsel assisted by Ms.H.Vani for the respondent assessee.

7. Sri.M.V.Seshachala contends that though the nomenclature is given as non-competition fee, the amount is received by the assessee in the course of business and accordingly it has to be treated as revenue receipt and in support of the said contention clause 16 of the agreement is pressed into service. The said clause reads as follows:

"CCL further confirms and agrees that with effect from the transfer of its rights as aforesaid, it will have no claims whatsoever with regard to the same. CCL, also undertakes, that with effect from the date on which payment of the consideration is completed as herein provided, it will not

access any know how or technology from Collaborators for the manufacture/sale of Quartz Alarm time Pieces or related products and also that it will not otherwise compete with Titan in the manufacture and sale of such products for a period of 10(Ten) years from such date."

He further contends that the assessee had number of divisions and it is only one unit i.e., one unit that was sold and contends that entire consideration is revenue receipt and relies upon the decision in the matter of Tam Tam Pedda Guruva Reddy V/s Joint Comnr. Of IT reported in (2007) 291 ITR 44.

8. Per contra the learned senior counsel Sri.Sarangan contends that it is a lumpsum amount which has been paid and contends that the burden lies on the Department to establish this fact and in the absence of it, it should be held in favour of the assessee as capital receipt. He further contends that it should

be looked into from the point of view of prayer and also press into service Sec.29 of Contract Act. He also contends that it is a lumpsum payment for sale of one unit of the assessee and there is no termination of any agency.

9. The following authorities are relied upon by the assessee.

(i) CIT Vs. Chari and Chari Ltd (1965) 56 ITR (Sh.N) 22 at pg 400.

(ii) CIT Vs. Best and Co.Private Ltd (60 ITR 11)

(iii) CIT Vs. Shaw Wallace (AIR 1932 PC 138).

(iv) Contract Act– 9TH Edition Vol. I Illustration No. 3, Sl.No.47 page 262 and Sl.No.49 page 266

(v) CIT.TN V/s Saraswathi Publicities (1981) 132 ITR 207.

(vi) (1983) 140 ITR 159

(vii) CIT V/s Late G.D.Naidu – (1987) 165 ITR 63 (Mad.)

(viii) Oberoi Hotels Pvt Ltd V/s CIT (1999) 236 ITR 903(SC)

(ix) CIT V/s Saroj Kumar Poddar (2005) 279 ITR 573(Cal)

(x) CIT V/s A.S.Wardekar (2006) 283 ITR 432 (Cal)

(xi) CIT V/s Shyam Sundar Chhapria (2008) 305 ITR 181 (MP)

(xii) Rohitasva Chand V/s CIT (2008) 306 ITR 242 (Delhi)

(xiii) CIT V/s Narendra D.Dusai (2008) 214 CTR 190 (Bom)

10. The issue that requires to be considered by us is that whether compensation which has been paid for agreeing to refrain from carrying on business as non-competition fee in respect of the unit is in the nature of capital receipt or revenue receipt. The Hon'ble Supreme Court while examining the said issue

in the case of Gillanders Arbuthnot and Co.Ltd Vs. Commissioner of Income –Tax, Calcutta 1964(Vol.LII) 283 held:

> "That if the profit making structure of the assessee is not affected by such transfer or such a transfer would not involve a loss of enduring trading asset by depriving the assessee of a trading avenue, leaving it free to devote its energies after the cancellation to carry on the rest of the business. The income cannot be treated as capital receipt and would be Revenue"

The tests to be adopted are enumerated by their Lordships in the said judgment, examining as to whether the compensation paid by the Principal Company for cancellation of the agency may be regarded as capital receipt or revenue receipt. The Hon'ble Supreme Court held as follows:

> "Examining the circumstances of the present case in the light of that principle, we agree with the High Court that **what was received by the appellant was income** and not

> capital. Compensation received by the appellant was for cancellation of the agency which was terminable at will. The appellant was to be paid an amount which was to be computed on the basis of the profits of the business. Under the letter dated March 11, 1947, the appellant was to be paid 'for the first three post-transfer years' two-fifths of the commission accrued on actual sales in the territory of the appellant's agency taken over by the Imperial Chemical Industries (India) Ltd., such commission to be computed at the rates of commission formerly paid to the appellant, and that in 'the third post-transfer year' the principal company was to pay the appellant in addition a sum equivalent to full commission on the sales for that year effected by the Imperial Chemical Industries (India) Ltd. In the appellant's territory calculated at the same rates."

The Hon'ble Supreme Court referred to the judgment rendered by the co-ordinate Bench on the same day in the case of Kettlewell Bullen and Co.Ltd., Vs.

Commissioner of Income-Tax, Calcutta 1964 (53) ITR 261 wherein it had been held as follows:

> " On an analysis of these cases which fall on two sides of the dividing line, a satisfactory measure of consistency in principle is disclosed. Where on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what is substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated) the receipt is revenue: where by the cancellation of an agency the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt."

Thus, the compensation if paid towards the loss of capital asset it will amount to capital receipt. On the other hand if the said amount is towards not carrying on the business activity of the assessee firm whereby the assessee would be deprived of its revenue that it may accrue from carrying on the business would definitely be termed as a revenue receipt. In the instant case the assessee company was refrained from manufacturing and selling only a few products for a period of 10 years which was revenue yielding to the assessee company. Thus from out of the business activity that was carried on by the assessee it had sold only one unit and thus there was no loss or transfer of the entire or part of the income and assessee continued with its business activity. Hence, it has to be held that the amount of Rs.20,00,000/- received by the assessee as revenue receipt.

11. Sri. Sarangan contends that said judgement is not applicable to the facts of the case in as much as there is no termination of agency and further on account of transfer of unit the asset has got transferred which in lieu of it assessee had received the amount and thus it has to be classified as Capital Receipt and relies upon the decision of Gillanders, Arbuthnot and Co, ltd, V/s CIT, Calcutta, (1964) 53 ITR 283 (SC). In the said case noticing its earlier Judgment Hon'ble Supreme Court held that cancellation of the Contract agency did not affect the profit making Structure of the appellant nor did it involve loss of an enduring asset and it merely deprived the appellant of a trading avenue leaving it free to devote its energies after the cancellation to carry on rest of the business and to replace the contract lost by a similar contract. We notice in the instant case that assessee is continuing its business and there is no prohibition for channelising and devoting all its energies even after the sale of its

unit to Titan Industries. In fact the turnover during the year was 77.79 crores as against 44.66 crores in last year. Thus, there was no loss of Income to assessee. Hence, the amount received by the assessee terming it "Non-Competition fee" cannot be termed as Capital receipt.

12. The next Judgement relied upon by Sri.G.Sarangan is CIT, Madras V/s Chari and Chari ltd., (1965) 56 ITR (Sh.N.22) at page 400. In the said case assessee was managing agent of 3 companies one which was an electricity undertaking and the said agency of electricity undertaking was prematurely terminated because the Madras Government exercise of its powers under Madras Electrical Undertakings Acquisition Act, 1949, compulsorily acquired the undertaking and lieu of it assessee was paid compensation and it has been held there in that department had failed to establish that case falls within the exception to ordinary rate except

holding that assessee continued with other 2 agencies. However, in the instant case the department has been able to establish that transfer did not result in any loss of Income to the assessee or any part of income generating apparatus and there was no loss on transfer of entire unit of the income generating apparatus. Hence, it has to be held that said Judgement relied would not be of any assistance to the assessee in the facts and circumstances of the case.

13. The next Judgement relied upon by the counsel for Assessee-respondent Sri.Sarangan is CIT-Madras V/s Best and Co (P) ltd., (1966) 60 ITR 11. It is brought to our notice the following passage of the dicta laid down in the said case, namely:

> "(ii) that restrictive covenant was an independent obligation which came into operation only when the agency was terminated and that part of the compensation which was attributable to the restrictive

covenant was a capital receipt and hence not taxable"

Their lordship have observed at page 17 to the following effect,

> "Whether the Compensation received by an assessee for the loss of agency is a capital receipt or a revenue receipt depends upon the circumstances of each case. Before coming to a conclusion one way or other, many questions have to be asked and answered: what was the scope of the earning apparatus or structure, from physical financial, commercial and administrative standpoints? If it was a business of taking agencies, how many agencies it had, what was their nature and variety? How were they acquired, how one or some of them were lost and what was the total income they were yielding? If one of them was given up, what was the average income of the agency lost? What was its proportion in relation to the total income of the company? What was the impact of giving it up on the structure of the entire business?

Did it amount to a loss of an enduring asset causing an unabsorbed shock dislocating the entire or a part of the earning apparatus or structure? Or was it a loss due to an ordinary incident in the course of the business? The answers to these questions would enable one to come to a conclusion whether the loss of a particular agency was incidental to the business or whether it amounted to a loss of an enduring asset. If it was the former, the compensation paid would be a revenue receipt; if it was the latter, it would be a capital receipt. But these questions can only be answered satisfactorily if the relevant material is available to the income-tax authorities. The evidence of witnesses in charge of the business, the relevant accounts and balance-sheets of the assessee before and after the loss, other evidence disclosing the previous history of the total business and the relative importance of the agency lost and the present position of the business after the loss of the said agency have to be scrutinized by the department"

Applying these principles in the instant case assessing officer has come to the conclusion that no loss has occurred to the assessee on account of transfer of enduring asset and as such that amount was brought to tax under Revenue receipt and this finding of fact recorded by him by applying the ratio of the Hon'ble Supreme Court referred to supra we find that both appellate authorities were in error in upsetting this finding of the Assessing Officer. Hence, we hold the above said judgement upon which relevance was placed by the learned Sr.Counsel does not come to rescue of assessee for treating Rs.20 lakhs as Capital receipt.

14. Another judgement relied upon by Sri.Sarangan learned Sr.Counsel is (1981) 140 ITR 207 CIT.T.N V/s Saraswathi Publicities wherein the assessee had agreed to refrain from carrying on business with Hindustan Lever to contend same is applicable to facts of the case. The said judgement though refers to

restrictive covenant their lordships have also referred to the various judgement of Supreme Court (referred to by us Supra) and came to the conclusion and held that termination of agency resulting in business loss is a capital receipt. However, on examination of facts of the present case by applying the principles enunciated by their Lordships of the Hon'ble Supreme Court we have held that sale of the unit has not resulted in loss to assessee and hence it has to be held revenue receipt. Thus, the said judgement is not applicable to the facts of this case.

15. The other Judgements relied upon by the let Sr.Counsel Sri.Sarangan are:

(i) (1983) 140 ITR 159

(ii) CIT V/s Late G.D.Naidu – (1987) 165 ITR 63 (Mad.)

(iii) Oberoi Hotels Pvt Ltd V/s CIT (1999) 236 ITR 903(SC)

(iv) CIT V/s Saroj Kumar Poddar (2005) 279 ITR 573(Cal)

(v) CIT V/s A.S.Wardekar (2006) 283 ITR 432 (Cal)

(vi) CIT V/s Shyam Sundar Chhapria (2008) 305 ITR 181 (MP)

(vii) Rohitasva Chand V/s CIT (2008) 306 ITR 242 (Delhi)

(viii) CIT V/s Narendra D.Dusai (2008) 214 CTR 190 (Bom)

In all the above judgements the restrictive covenant Viz., non-competition clause in the Agreement has been considered by their lordships with reference to the facts of those cases and have come to conclusion that it does result in (a) loss of an enduring asset or (b) loss of income to the assessee and accordingly held it would be capital receipt and not exigible to tax. Per Contra in the instant case we have held that in the instant case it has not resulted in the loss of enduring asset nor it has

resulted in loss of income of the assessee but on the other hand, turnover of the assessee has increased. Hence, we have no option but to hold that these authorities would not be of any assistance to the assessee in the present case.

16. Yet another Judgement relied upon by assessee to repel ground No:9 urged by revenue with regard to applications of Sec 55(2) of Act is CIT Vs. Narendra D.Desai (2008) 214 CTR 190 (BOM). The revenue has contended that by bringing in an amendment to Sec 55(2) of the Act was in order to crystalise the existing practice and Legal position by way of a legislation and not to take converse view that this legislation was not applicable for earlier assessment years. It is seen from the judgement that it has been held therein that in the facts and circumstances of the case therein it had been held, it was a capital receipt and receipt of the same during the year in question and

it was held that Section 55(2) of the Act would not be applicable. It would not be out of place for us to mention here that unless section is brought about in the Statute retrospectively, it cannot be made applicable unless it is held that it is clarificatory legislation. We do not wish to embark upon enquiry on the this issue, since we have held in the facts and circumstances of this case the receipt of the amount by the assessee as revenue receipt and exigible to tax.

17. In view of the above discussion we hold that the Appellate Authorities were in error in holding that the sum of Rs.20,00,000/- received by the assessee as non competition fee should be treated as capital receipt and not as revenue receipt.

18. For the reasons above said, we allow this appeal and answer the question of law formulated

herein above in favour of the revenue and against the assessee.

Sd/-
JUDGE

Sd/-
Judge

Sbb/-